RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Apr. 6 DJIA 2717.12 PTI 3251; A-D Ratio -10.22
Apr. 12 DJIA 2751.80; PTI 3248; A-D Ratio -10.15
Dow Yield: 3.50%; Dow P/E: 11.8; DowPow: 355
Dow Book Value: 1075; Dow 200-day MA: 2668
Percentage of Undervalued Blue-chips: 22%
PTI 89-day Moving Average: 3278

THE PICTURE: Every quarter the esteemed London *Economist* polls a number of outstanding institutions such as Morgan Stanley, Scudder, Stevens & Clark, Daiwa Europe, Brown Brothers Harriman, regarding their investment stance. The latest poll shows that despite the Japanese market collapse, despite world inflation fears, despite US deficits, "all the investment managers polled by the *Economist* prefer equities for the bulk of their holdings, just as they did in January."

Running over the list, I note that these institutions, on average, hold above 70% of their managed assets in equities. States the *Economist* rather cryptically, "One reason the managers like shares is that they distrust bonds." So the picture is clear. Major institutions in the US and around the world are heavily invested in stocks.

Does that tell us anything about the future of the stock market? My answer is, "No, it does not." It merely tells us what the institutions have done in the past. It's history.

All right, suppose we could poll 1 million investors regarding their positions in the markets. And suppose 80% of them said they owned stocks. Would that tell us anything? Again, I say no. All it would provide us with is another bit of history. If the stock market could be predicted on the basis of polls -- polls of the average Joe and Jane or polls of supposedly sophisticated institutions -- this business would be a lead pipe cinch. There's only one problem -- polls don't work where Wall Street is concerned.

But that doesn't seem logical, does it? After all, the market is made up of the minds and acts of individuals and institutions. Then why in the devil can't we know what the market is going to do if we poll the people and institutions who make the market?

The answer is that all polls are history. Furthermore, what people say and what they actually do are often quite different. Finally, even intentions can change in an hour.

But there's another very important factor. And it's that the market doesn't act as if it was a simple collection of intentions. No, the market acts like a living organism -- and an ornery organism at that. Those of us who have been following the market for years know that the market performs as if it has a life and a mind of its own. Let it be known that the leading institutions of the world have sold stocks and are bearish, and can you believe it -- a bull market begins. Let it be known that the public is bullish and is standing in line to buy shares and gad, the market falls out of bed. Let insiders buy their heads off for months and hey -- the market goes into an extended trading range. The market is a monster, and no device or technique or poll ever invented has been able to predict its future with anything like certainty.

Of course, that's both the frustrations and the fascination of the game. Every day literally millions of man-hours are expended in trying to squeeze profits out of the market monster. But the monster is stingy, and profits go to the very few.

I'm one of those students who puzzle over the trends. I have almost half a century of experience, I've known many of the greats -- Garfield Drew, John Magee, Hamilton Bolton, Edson Gould, George Schaefer -- and I've learned from each of them. But as to finding the formula that will beat the market, nobody has ever come up with THE answer.

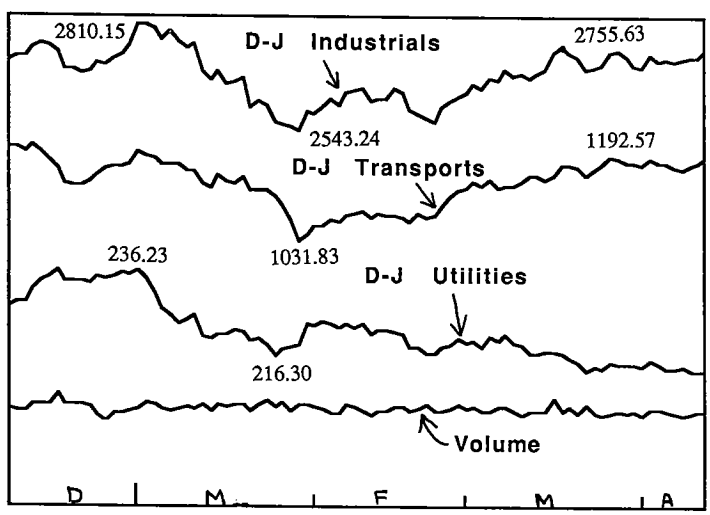
In my opinion, George Schaefer possessed the greatest feel for the primary trend of anyone who ever lived. Schaefer called the beginning of the great 1949-66 bull market practically to the day, and if anyone doubts that, I have his June 18, 1949, report to prove it. Schaefer knew as well as anyone the fortune-making power of a bull market and the wallet-busting power of a bear market. I learned a great deal from Schaefer, probably more than from anyone else, with the exception of Robert Rhea. Rhea was in my opinion, the greatest of all readers of the price action. All right, enough rambling.

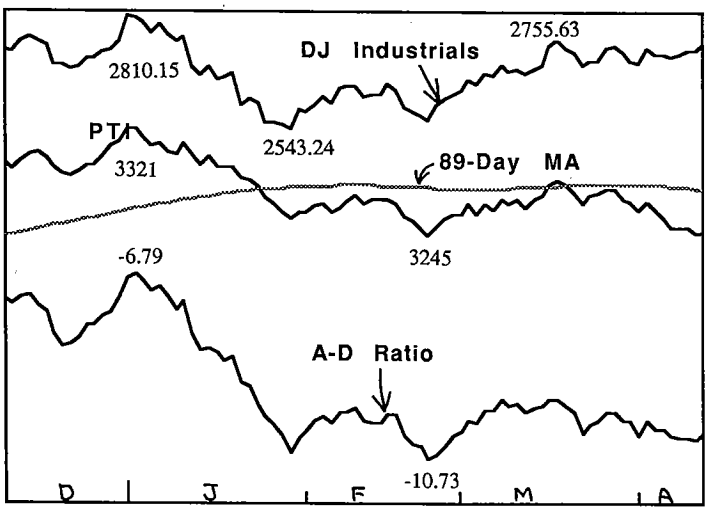
Let's turn to the **current market.** As I see it, the 1990 market is a bull-faced Dow standing on a leaky, sieve-like market. The year 1990 began with a 267 point drop in the Dow, followed by a 212 point recovery. The rally recouped 80% of the Dow's losses, but the rest of the market was loath to follow -- all typical bear market action.

I wrote in the last Letter that the bear is a character actor. And the part the bear wants to play is this -- he would love us to believe that he's a bull. I feel that the bear has been playing this part since late-January 1990.

Let's take a cold look at what's been happening. For one thing, on April 12, the Dow climbed to within 59 points of its January 1990 high of 2810.15 . This is the kind of action that gives the public confidence. "The Dow is up, it's trying for the highs, and all is well." Which is still the prevailing attitude today.

The Transportation Average is another story. Following its 1989 high of 1532.01, the Transports smashed to a 1990 low of 1031.83, a loss of almost one-third of their value. Since its January low, the closest the Transports have come to their 1989 high was 340 points away on March 27.





The D-J Utility Average hit a bull market high of 236.23 on January 2. The Utilities have been drifting down ever since. On April 12 the Utilities closed within a fraction of their low for the year (low was 212.30).

Now turn to the chart at the top of page 2. This picture probably tells us more than anything else about this market. First, it's clear that since the primary bear signal of January 25, 1990, the Dow has been pretty much bouncing around in a trading range.

At the bottom of the chart we see the advance-decline ratio, an index which can be considered a proxy for ALL the stocks on the NYSE. The A-D ratio hit a peak of minus 5.47 on September 1, 1989. From there it dropped irregularly lower, touching an extreme low of minus 10.73 on February 23.

The rally off the February low was exceptionally weak, and it advanced the A-D ratio less than two points off the low. What the A-D ratio is telling us is that as far as the majority of NYSE stocks is concerned, the bear has been firmly but subtly in control.

Finally, I come to my proprietary instrument -- the Primary Trend Index.. Ever since its January 1988 bull signal the PTI has been leading the market higher. But on January 25, 1990, the PTI finally turned bearish as it broke below its 89-day moving average. Heading down, the PTI hit a low on February 23 of 3245 (see page 2 chart). From there the PTI rallied back to its moving average, then turned down again. The Dow closed last week (April 12) only 59 points below its record high. But April 12 found the PTI only five points above its February 23 low of 3245. Instead of leading, the PTI is now lagging badly. And it remains in the bearish mode.

Veteran readers of there reports know that I put a tremendous amount of stock in the action of both the PTI and the A-D ratio. You can't have a bull market when the majority of stocks are declining, and the A-D ratio has shown us that since September 1, 1989 (a period of over five months), the majority of stocks on the NYSE have been declining.

When the majority of stocks are declining it's mighty hard to tell the story. When the A-D ratio and the PTI are heading down, portfolios, the great majority of them, will shows losses.

Most Managers Lost Money in Quarter For Worst Results Since '87 Stock Crash

By James A. White
Staff Reporter of The Wall Street Journal

NEW YORK—Most stock portfolio managers lost money in the first quarter for well in the first quarter, thinks that small stocks have finally turned the corner, after being out of favor for much of the 1980s, says vice president Jeff Cardon. Founded

COMMENT: This is a frustrating and difficult market in which nothing decisive seems to get done. It may well be that the Dow will have to rally to a new high, above 2810.15, before we can see what's really going on. A new Dow high would be unconfirmed by the Transports and almost every other indicator. Furthermore, an unconfirmed Dow high could trigger a major decline, the kind that could take this market to an important oversold condition. The fact is that since February the Dow has wanted to go up and the rest of the market has wanted to go down. So let 'em go, let the Dow try for a new unconfirmed high and then we'll see what we've got.

ECONOMICS: Let's keep it simple. Marty Zweig, in his latest *Zweig Forecast*, notes that in the past whenever M-3 and the leading economic indicators were both negative on a year-to-year basis, we've had recessions. When it happened in peacetime (as it's happening now), in nine instances out of nine, we've had recessions or depressions. But you wouldn't know it from the action of the CRB Commodity Futures Index, which last week pushed above 241, its highest level in a year. Could we have the worst of both worlds -- inflation and recession?

C.J. Lawrence's bank analyst, Carole Berger, notes bank regulators have triggered a credit crunch that could be as rough as the one that hit in 1980 -- although the current one comes when the banks are very much more leveraged. The bank stock index has already lost half its value, and Berger has pulled most banks from her recommended list (thanks Ed Hyman for this info).

INTERNATIONAL: David Fuller (*International Investment Letter*, 7 Swallow St., London W1R 7HD, England) publishes my favorite international market letter. In his latest report Fuller states, "An unprecedented number of secular trend changes are occurring -- Conflicting evidence (regarding global stockmarkets) but the bearish factors dominate --Six (of 26) international stockmarkets have now retraced their 1989 gains -- the dollar should see a further technical rally, but it won't last." That's the word from England (and sorry I missed you last month when you were in LA, David).

INVESTMENT POSITION: It's been a deceptive and difficult year so far with the bear subtly dominating. My guess is that somewhere ahead (possibly after a new high in the Dow) there's going to be a heavy spate of true bear market selling, -- followed by a technically oversold market. If you have a mind to trade, THAT oversold spot will be the place to make your purchases.

In the meantime, keep your powder dry. I opt for a lot of liquidity here, and I feel particularly comfortable with Treasury bills. I'm not trying to make a killing in this area, I'm waiting for the market to become attractive, which means heavily oversold.

By the way, the best investment category in 1990 so far has been T-bills. Price changes in other areas for the first quarter: Dow down 1.67%, S&P 500 down 3.81%, S&P Financials down 10.7%, Value Line Comp. down 5.76%, T-Bonds down 4.6%.

LOOKING AHEAD: *Growth Fund Guide* (Box 6600, Rapid City, SD 57709) publishes outstanding historical studies. In their latest issue, *GFG* states that important declines and subsequent buy spots have occurred in every tenth year (i.e., 1910, 1920, 1930, etc.) since 1890. The largest of these was the 46.4% Dow decline of 1930, the smallest was the 13.5% decline of 1950. Since 1890 there have been eleven tenth-year declines, and the average Dow loss during these declines was 25.5%. But note this -- the average Dow gain following these tenth-year declines was 32.7%. The average tenth-year decline started in March and ended in August of the year. If 1990 were to conform exactly to the average of past years (of course it won't), we would see the Dow at 2100 around August or a bit later. Following that low, we would see a major and profitable rise.

In view of the above, let's be constructive, or shall I call it forward looking. One thing bear markets ultimately produce is profitable buy spots. We've seen many of them in the past, spots such as those that appeared in late-1966 or late-1974 or mid-1982.

There are two kinds of buy spots -- good ones and great ones. The one's mentioned above, of course, were great ones. But what's the difference between a good buy spot and a great spot? The difference is this -- good buy spots are basically technical. They are created as a result of a lot of selling, too much selling as a matter of fact. When too many people rush for the exit doors, the market becomes "oversold." When that happens Wall Street runs out of sellers, pessimism reigns -- and voila, a good buy spot is created. This kind of buy spot may have little or nothing to do with fundamentals or stock values. It has to do with sentiment.

Great buy spots have all the components listed above plus an important added ingredient. They are accompanied by outstanding fundamentals. At great buys spots (which usually occur at bear market bottoms) the market is not only sold-out, pessimism is not only prominent, but stocks are a screaming buy based on values. The last really great buy spot appeared in late-1974, although another awfully good buy spot (probably great) occurred in 1982.

There are many tests of value, but the simplest is based on three items -- yields on blue chips stocks, confirmed with price/earnings ratios and book value levels.

Where are we now? Right now the **yield** on the Dow is at 3.6%, which tells us that stocks are still dear. Historically, great value in the Dow occurs when that Average provides a yield or around 6%.

Currently, the Dow is selling at a **price to earnings ratio** of around 11.8. In late-1974 at the bear market bottom, the Dow was selling at a give-away P/E ratio of 7. So on a P/E basis, stocks are in the middle ground.

When the Dow is selling below its actual **book value** it is considered to be in the bargain range. When the Dow is selling at double its book value it can be considered expensive. Currently, the Dow is selling at around 2.46 times its book value. In his latest mailing, my friend, Charles Allmon, of *Growth Stock Outlook,* offers some wise words on this subject. He writes, "We point out again that the price to book value of the DJIA on 3/15/90 was 2.4 to 1, an extreme valuation seldom seen over the past 100 years. When the Dow sold at 2.62 times book value on January 2, 1990, this figure was exceeded only twice -- in 1929 and 1987. You all know what happened shortly thereafter."

Somewhere ahead we are going to get a buy spot, either a good one based on a market which is technically sold out -- or a great one based on a market that is not only sold out but one that also offers great stock values.

How do we identify such areas? The great values areas are easy enough to spot, based simply on the criteria discussed above. Of course, a market can drop to the point where it provides a great value market, and stocks will continue to go down. And the further down stocks go, the greater value they become. In view of this, how do we identify the ultimate bottom?

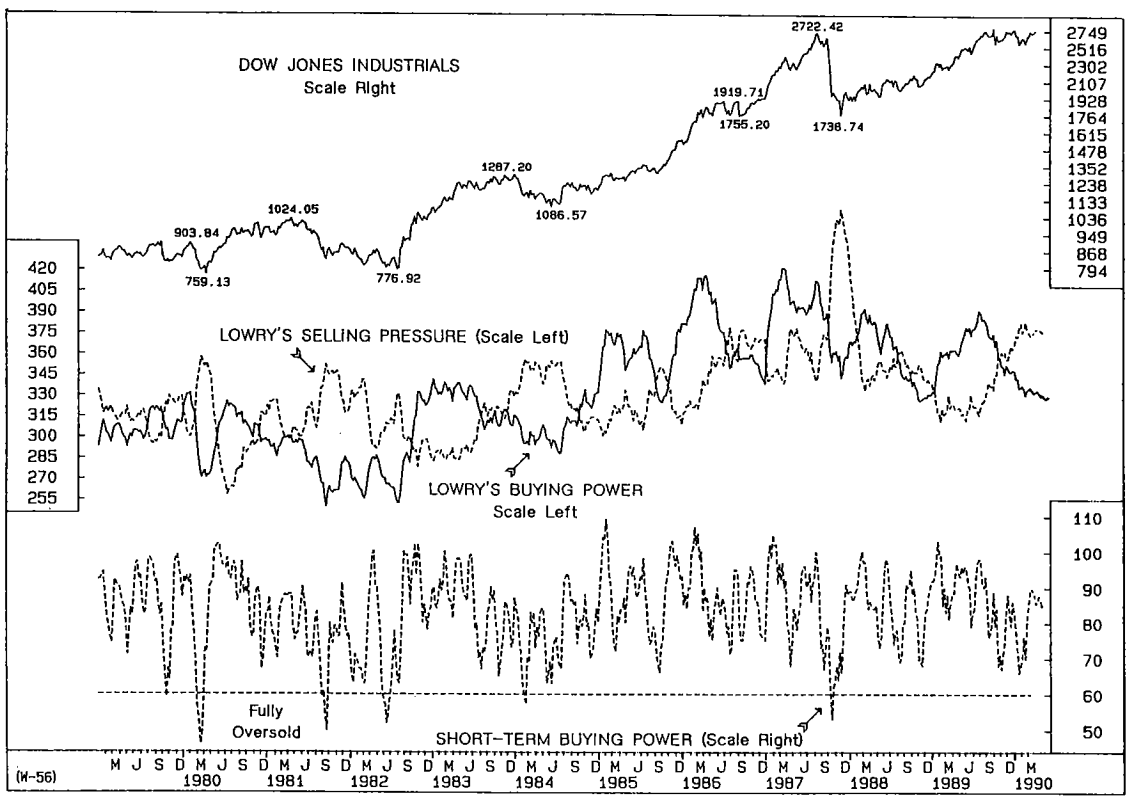
The answer is that usually there is a non-confirmation or a series of non-confirmations at the bottom. My PTI will stop going down or the Transports will refuse to confirm the Dow on the downside or daily new lows will start contracting or the Utility Average will start to rally. But let's not worry about that now.

What I do want to discuss is a study that I have followed for decades. This is the *Lowry Buying Power and Selling Pressure* study. I have included Ned Davis' chart of *Lowry's,* a chart that goes back to 1980 (Lowry's, 701 N. Federal Highway, N. Palm Beach, Fla. 33408).

The basis of the *Lowry* studies is daily tabulations of all upside points on the NYSE (points gained by individual stocks) and all upside volume (volume gained by individual stocks), and all downside points and downside volume. The Buying Power and Selling Pressure lines at the center of the accompanying chart are longer-term moving averages of these daily tabulations.

When the Selling Pressure line crosses above the Buying Power line, that crossing constitutes a **major sell signal** for common stocks. You can see a number of these bearish crossings on the chart.

The classic **buy signal** comes from the action of the Short-Term Buying Power line, the line seen at the bottom of the chart. This is



merely a short-term moving average of the daily buy tabulations, as opposed to the longer-term Buying Power line seen at the center of the chart.

When the Short Term Buying Power index drops below 60 on the chart it is an indication that the market is in classic oversold territory. It takes heavy selling to drive the Short Term index below 60, but there is a plus in this. For although such action only occurs in liquidating markets, once the Short term Buying Power index dives under 60 you know you are somewhere close to an important bottom. The buy signal comes when the Short Term index turns up from below 60 confirmed with a drop-off of the longer-term selling pressure line.

I have checked these buy signals going back to the late 1930s. They have appeared at an average rate of slightly more than one a year. Studying this chart, you will notice that in the nine years since 1980 there have been only five buy signals. This is an unusually small number, in the light of past history. But the stock market usually evens things out over any extended period of time, so it could very well be that there will be an abundance of "below 60" instances in the Short-Term Buying Power index during coming years.

This is interesting. Since or including the year, the Short-Term index dropped under 60 on only two occasions -- once in 1984 and again in 1987. Both of these periods of intense liquidation were followed by extremely profitable advances.

Based on historical periodicity, we are now overdue for another period of intense selling, selling powerful enough to drive the Short-Term Buying Power Index below the 60 level-- followed, of course, by a major buy signal. For that reason, I feel that the correct attitude now is this -- each month that goes by without bringing on intense selling is a month nearer the time when we can expect just such action to occur.

I have studied the *Lowry* tabulations for many years, and I note this -- the longer the period of elapsed time before an under 60 (oversold condition) arrives, the greater the likelihood that when that condition does arrive, it will be a whopper (i.e., a major period of intense liquidation and a correspondingly more profitable buy period).

An example is the period seen on the chart. The Short-Term Power index dove under 60 in February 1984, then rose to give a buy signal. For the rest of 1984, all of 1985, all of 1986 and most of 1987, the Short-Term Power index managed to hold above 60. In other words, during all that period following the 1984 buy signal there was no intense liquidation. Then in October 1987 the market made up for it. Wall Street suffered its worst one-day crash in history. The powerful selling action was very overdue. The chart tells us that.

Where are we now? The last period of intense liquidation was October 1987. At no time since then has the Short-Term index plunged below 60. Note (center of the chart) that the longer-term Selling Pressure line is now well above the Buying Power Line. This means that despite what you may think, the sellers are dominating in this market. Once selling pressure dominates, major buyers will generally not come back into the market again until stocks sink into an oversold condition.

Thus for us, the correct and safe position now is to wait patiently for an oversold situation, a situation in which Lowry's Short-Term Power index drops below 60. Time is now on the side of those who are patiently waiting.

When this market is in a true oversold condition I will report it. But in the meantime, it may be boring, it may try our patience, but this is waiting time, a time to keep our powder dry. Remember the old adage -- "The market is always there." **We can't make the market do what we want. But we can wait until what we want appears in the market -- and it will.**

NOTES & QUOTES: Europe, with Germany the obvious leader, is feeling its oats. Listen to Jans-Jorg Rudloff, chairman of Credit Suisse-First Boston, "The European challenge is to restore the Europe of 1914, when Europe was the biggest economic power in the world and had the best educated population." Here's Sir Denys Henderson, CEO of Imperial Chemicals, talking about German reunification, "It will put German industry in a very strong position. We will have to run like mad to improve our productivity, our technological base and international presence." Here's Carlo de Benedetti, CEO of Olivetti, "We should speed up the process of uniting Europe. If you really unite markets, you have to speed up having a united currency and monetary system." These are the thoughts and desires of European industrial leaders. And they aren't kidding around.

Hundreds of billions of marks and dollars are going to East Germany and Eastern Europe. There will be an accompanying cutoff of capital going to the underdeveloped nations. West Germany will gear up to lead Europe and maybe the world in production. Europe has already conceded Germany's lead.

The world power setup is rapidly changing. Economic might, not military might, will lead the world (I've been saying this for months). In the US there will have to be major adjustments to the new world of economic might. In the new world (in my opinion), US military spending will be an albatross around the neck of Uncle Sam. But the military has a powerful presence in Washington. The battle for a much smaller military is coming. And the battle will be fierce. Ultimately, like it or not, economics will be the winner.

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Along these lines, I was particularly interested in this piece from the April 4 *NY Times*. At least the head of the Senate Intelligence Committee agrees with my assessment.

U.S. URGED TO SHIFT TO ECONOMIC GOALS

Senator Seeks a New Policy Not Grounded in Military Rivalry With Soviets

By MICHAEL WINES
Special to The New York Times

WASHINGTON, April 3 — Promoting a new foreign policy that is not rooted in rivalry with the Soviets, the chairman of the Senate Intelligence Committee, David L. Boren, warned today that the United States risks losing its pre-eminence unless it adjusts to a world order based on economic, not military, might.

Mr. Boren said the alliance of nations that has dwelled under the American military umbrella since 1945 is fragmenting as its members pursue their own economic interests, no longer fearing a Soviet military threat.

In "a strange and symbiotic" way, the United States has also relied on the Soviets for those 45 years to justify its world leadership, Senator Boren said:

* *

Speaking of the coming struggle for economic leadership, mull over this little piece. Talk about growth, the biggest growth item in the world today is probably the US federal debt. The politicians and the administration can blather all they want about how the debt is under control; the one thing they can't sweep under the political rug are the figures.

Debt Tops $3 Trillion

—WASHINGTON, April 3 (AP) — The national debt totaled more than $3 trillion on Monday, for the first time in history, the Treasury Department reported today.

The actual level of public debt subject to statutory limit at the end of the day on Monday was $3.023 trillion. That was just $99.59 billion under the statutory limit of $3.123 trillion. The national debt stood at $2.989 trillion on Friday.

Congress enacted the current debt limit last November.

The debt reached $1 billion in 1916 during World War I, climbing to $278 billion at the end of World War II.

It reached its first trillion on Oct. 1, 1981, and rose to $2 trillion on April 3, 1986.

The rapid growth in the debt stems from fact that the Government has been running huge deficits for the last decade.

You want to know the real story of the federal debt. Just study these US Treasury statistics. Federal debt as of April 11, 1989 was $2.755 trillion. Federal debt as of April 6, 1990 was $3.029 trillion. That's an increase of $274 billion in one year. Or to put it another way, that's the federal debt increasing at the astounding rate of **$5.26 billion a week**. Show that to your congressman!

U.S. Finances

for Wednesday, April 12, 1989

WASHINGTON (AP) — Here are figures on government spending and debt (last six digits are eliminated). The government's fiscal year runs Oct. 1 through Sept. 30.

Total public debt April 11	(2,755,012)
Statutory debt limit	2,800,000
Operating balance April 11	9,417
Interest fiscal 1989 thru Feb.	100,493

U.S. Finances 1990

WASHINGTON (AP) — Here are figures on government spending and debt (last six digits are eliminated). The government's fiscal year runs Oct. 1 through Sept. 30.

Total public debt April 6	(3,029,503)
Statutory debt limit	3,122,700
Operating balance April 6	7,707
Interest fiscal 1990 thru Feb	111,727

This kind of debt explosion is not sustainable. Ultimately, it will lead either to a collapse of the financial system or a run on the dollar. In the past, big deficits have been translated into inflation. But whether the markets can handle this kind of debt monster in an orderly way (even via inflation) is questionable. At any rate, you can see why I want subscribers to hold gold. With debt building at the rate of over $5 billion a week, the dollar, somewhere along the line, has to come into question. It's only a matter of timing.

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Manhattan magazine (April) contains an article on *Bride's* magazine. The massive February-March issue of Bride's has 1,040 pages, weighs four pounds, and contains $10 million of advertising. Now that is an issue. *Bride's* editor, Nancy Tober, notes there are five kinds of marriages: (1) Total, where the couple work and live together and are totally involved; (2) Vital, where the two people do entirely different things but they're both very involved in their lives and "they get together and communicate well together"; (3) Passive Congenial, "Where the two people go along on separate tracks"; (4) Devitalized, "Where he comes home too late to talk to her, and they never have anything in common. A lot of marriages in Hollywood end up like this, where the two people drift apart."; and (5) Conflict Oriented, "Where you fight over breakfast and over dinner and where there's a lot of violence. These marriages usually end in divorce." Russell comment: I never thought of it this way -- interesting, which brand of marriage do you have?

* *

I consider the London *Economist* one of the great magazines of our era. How they pack so much news and information into every weekly issue is beyond me. The April 6 issue has a story significantly titled, "America's Money Politics"; the subtitle is "How to stop congressmen selling their souls for the money to get themselves elected." The piece notes the typical member of Congress "is now less likely to be defeated every two years than the average member of the House of Lords is to die over the same period." They also note congressmen spend at the rate of $17,000 a month for their next election.

Personally, I feel it's disgusting, and I've ranted about our "lifetime congressmen" for years. I'm for limited terms in Congress. What's the matter with these guys? Can't they make a living anywhere else? I don't want lifetime politicians in there -- cowards, reckless spenders, irresponsible. The only answer is a limit to terms of office, but I doubt that will ever happen. Congress makes the laws. Thus the whole congressional situation has taken on a life of its own. And the federal debt, under supposedly conservative Republican presidents, has (over the last decade) boomed from $1 trillion to $3 trillion.

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Quote of the Week: From Thomas Mann of the Brookings Institute: "Ronald Reagan is Congress' role model. He demonstrated that you could be politically successful while creating a fiscal mess."

* *

Everybody, at some time in his life, wants to start a magazine or own a restaurant. Before you do either, consider the following: 50% of all new restaurants go belly up their first year. And magazines? *S&P Rate & Data* listed 1,275 mags in their 1988 reference guide. Of those, 785 no longer exist.

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In an interesting article in the April 8 *NY Times*, Madis Senner, president of an international money management firm, states: "The interest rate forecast (i.e., lower rates) is all wrong." Why? According to Senner: (1) The Japanese raised money cheaply and easily with equity derivatives, such as bonds which are convertible into stocks. But with the crash in the Tokyo market, there's been a one-month moratorium on the issuance of new equity derivatives by Japanese corporations. (2) The East bloc countries will be bidding for huge amounts of the world's capital. (3) Major governments are planning to issue more bonds over the foreseeable future. Senner conclusion: "The disinflation that drove down interest rates in the 1980's has been replaced by a new phenomenon: less capital available from Japan and other surplus countries and increasing demand."

Russell comment: I tend to agree. Furthermore, it's significant that many individual states in the US are now running whopping deficits and will have to raise money. In fact, the financial situation is so bad (particularly in the Northeast) that 10 incumbent governors have decided not to seek re-election this year. Among those stepping down -- O'Neill of Conn., Deukmejian of Calif., Thompson of Ill., Cowper of Alaska, Mofford of Ariz., Goldschmidt of Oregon, Bellmon of Okla., and Clements of Texas.

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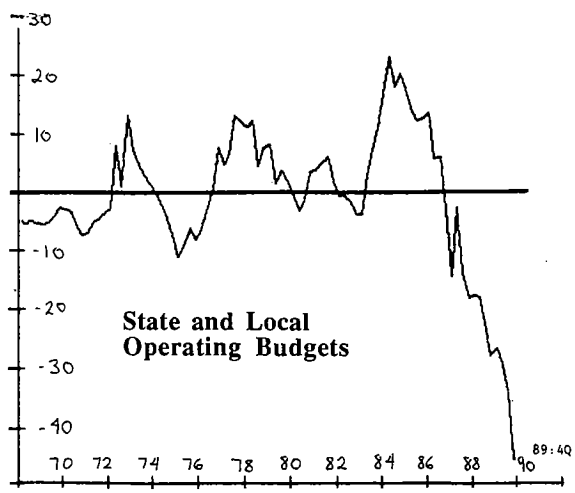
Ed Hyman of *C.J. Lawrence* just published this chart showing the balance of state and local operating budgets through the fourth quarter of '89. Says Ed, "Because the state & local governments are running such big deficits, they are likely to raise taxes and cut spending. Expect muni downgrades in 1990." Russell comment: Expect the issuance of many more bonds to cover deficits.



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In a new book, "The Impoverished Superpower," authors Henry Rowen and Charles Wolf state that Soviet economic statistics are so bad the Soviets often depend on US intelligence analysts to tell them what is going on in their own country. The book states the Soviets have been fooling themselves about the size of their military spending which has actually amounted to an unbelievable 30% of Soviet GNP (as against 6% in the US). This has resulted in a massive military structure built on the base of a third world economy. To change this weird structure, say the authors, would require an unbelievable re-allocation of Soviet resources and a fantastic switch in the Soviet bureaucracy which still controls everything but produces nothing.

The authors believe the reason the Soviets have moved at all is their fear of becoming a second-rate power with an economy so weak it can't keep up with the revolution in military technology. Their conclusion: Don't count on real Soviet disarmament. There is tremendous resistance on the part of the Soviets to decreasing the power of their military. "The Soviets conceive of their military in an entirely different way than the Western nations do, and it does not necessarily follow that Soviet economic crisis means Soviet disarmament." Russell opinion: I foresee the Soviet economic

situation becoming so bad they will be forced to shrink their military -- but by how much is the question.

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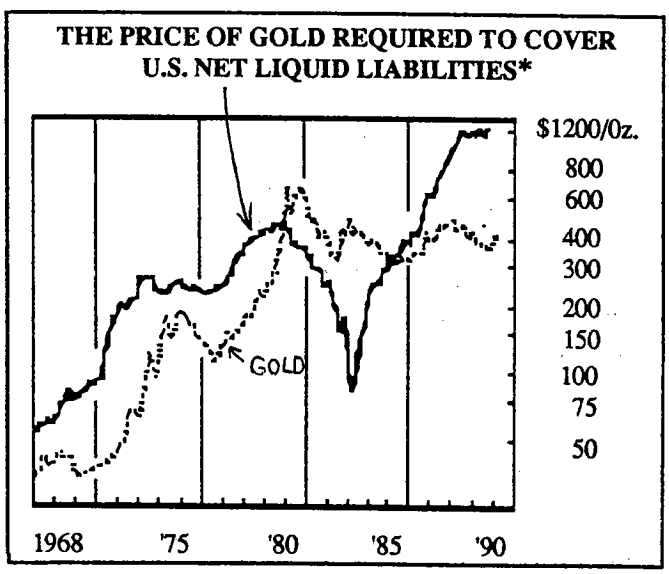
My good friend, Jon Strebler, has just completed his MA thesis entitled "San Diego Housing Prices, 1887 to 1989, the Myth of Invincibility." Jon is a market man, and this excellent 95-page work is a must for anyone who is seriously interested in California real estate, its history, and what to expect in the future. Many valuable long-term charts, and a load of original research are included. Copies are available from Jon Strebler, c/o Dean Witter, PO Box 1790, La Mesa, CA 92044. Price $30.

SIGNS of the TIMES: The General Accounting Office now estimates the S&L bailout could cost as much as $500 billion. Last week the US authorized another $45.3 billion borrowing to cover the gathering S&L fiasco. . . . On March 11, the D-J 20-Bond Average, quietly and unnoticed, dropped to its lowest level of the past 13 months. . . . William Schreyer, CEO of Merrill Lynch, took a 38% cut in salary (down to $1.55 million) as Merrill posted its first loss since going public in 1971. . . . Last week the London FTSE 30 Average (comparable to the Dow) hit a low for the year at 1740.20. Again last week, the NYSE Financial Index (all financial stocks including banks, brokers, S&Ls, factors, etc.) hit its lowest level in a year. Bank stocks littered last week's new low list including Citicorp, Bank of NY, Banker's Trust of NY, Continental Bank, First Fidelity Bank, Mellon Bank. . . . My five-day moving average of daily new lows (NYSE) is now well above the five-day MA of new highs. This is extraordinary action considering the Dow is within striking distance of its all-time high. Obviously, there is a lot of distribution going on.

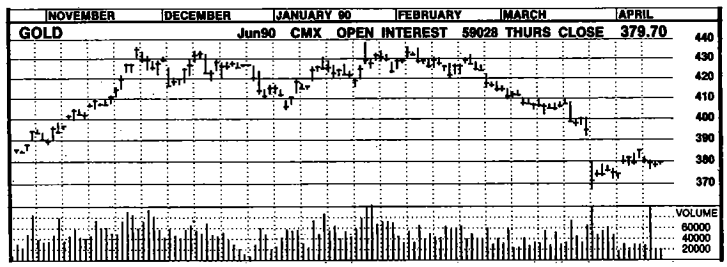
GOLD: The rumors abound. Here's one: A deal was made in which the Saudi Arabian Monetary Authority agreed to dump gold on the open market, ostensively to "punish" those who were accumulating gold steadily. The Saudis have been sophisticated gold traders, and it is inconceivable that they wouldn't have sold their two million ounces of gold much more carefully, without knocking the price down $23 in a day. Why would the Saudis do it? Probably on the promise of a good arms deal from the US somewhere in the future. But here's an even better story. According to William Safire in the *NY Times* (Apr. 13), the Russians, falling behind on grain payments and desperate for immediate hard cash, gave orders through their Swiss bankers for a massive quantity of gold to be sold (it was sold through the Saudis). Take your choice, but the Russian story, I feel, has the ring of truth about it.

So much for the stories. Now examine this chart published a few months ago by the *Bank Credit Analyst*. Here we see the actual price of gold (dotted line) and the price gold would have to be in order to cover US liabilities owned by foreigners (the dark line).



Note that over the years the price of gold tends to follow (sometimes quite irregularly) the liability line.

This chart from *Investor's Daily* shows the recent gapping down to lows in gold, and then the gap to the upside. The result is a downside "island reversal", a formation often associated with an important bottom. Obviously, the recent gold break damaged, actually wounded, the price structure. Wounds take time to heal, and this one will too. I continue to feel that gold below 400 is "cheap gold."



Everything is a matter of timing. And timing the move in gold is something I have not wanted to do. This is the reason why I have suggested that my subscribers purchase a fixed-dollar amount of gold coins each month. Forget the timing, I'm talking about accumulating gold, building up a position in the actual metal.

With the re-industrialization of East Europe, with the Soviets moving (slow as they are) into the Free World's economy, with tremendous needs for capital in S. America and Africa, an enormous amount of paper money and credit will be created over coming years.

The more paper and credit and credit guarantees that are created, the more upward pressure there will be on gold. But remember the old adage, "The market always does what it's supposed to -- but never when." I apply that to gold.

LATE NOTES: The Group of Seven, meeting in Paris last week, twiddled their thumbs and did little or nothing to help the yen. The Japanese would like the US to lower its interest rates to help the yen, but it looks as if Japan will have to do it the hard way -- which means raising their own rates again. Another boost in Japanese rates could hit the wobbly Tokyo stock market hard. The rosy, bubbly times in Japan may be a thing of the past. But as I've said so many times before, the real story is in Japan's wildly inflated real estate prices. Tokyo residential home prices are now weakening. If real estate prices in Tokyo decline in earnest, that's the point where today's mild trouble will turn to nasty trouble for Japan.

Of course, the same thing could be said of US real estate (as far as the public is concerned, the wealth of America is in their homes). So far, US real estate weakness has been confined to specific areas, and there has been no across-the-land slump. For years California has been the hot area for real estate with meaningful corrections being avoided. Newcomers to the Coast can't believe the prices, which are totally out of whack with the potential return on investment.

If you're a technician, you've got to be fascinated and mystified by what's going on in the stock market. You seldom see such persistent price/breadth divergence. The Dow doesn't seem to want to go down, while the majority of stocks on all the exchanges don't seem to want to go up. Week ending April 12: Dow up 34 points; 915 issues up but 938 issues down; 53 new highs but 145 new lows. Can this kind of action continue? Fourth quarter of '89 was the fourth consecutive quarter of decline in corporate profits, and the first quarter of '90 could be more of the same.

NEXT MAILING: May 2